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Subsidies and Unfair Competition in Global Commercial Aviation: How to Respond

Thomas J. Duesterberg, Ph.D.

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Executive Summary

Commercial air passenger service is a mixed business with privately owned companies competing against state-owned enterprises (SOEs) and partially state-owned firms throughout much of the world. Because World Trade Organization (WTO) rules and those of other trade agreements do not apply to international air passenger service, a system of bilateral "Open Skies" agreements has developed in order to open markets, reduce government interference in international aviation, and facilitate efficient resolution of disputes over rates, landing rights, and general fair practices for commercial aviation. In recent years, heavily subsidized SOEs in the Persian Gulf states Qatar and the United Arab Emirates (UAE) have posed a major challenge to the maintenance of a stable Open Skies regime, however. Using tens of billions of dollars in government-provided capital not available to their overseas competitors, these SOEs have taken significant market share from established airlines in the United States, Europe, Australia, and India, for example. And subsidized SOE air carriers in China—which has no open skies agreements with the world's major industrialized nations except Australia—are beginning to raise many of the same concerns.

Earlier in 2018, the United States and the two Gulf sheikdoms concluded separate bilateral agreements intended to begin addressing this problem. Both accords mandated greater transparency in accounting by Qatari and UAE-owned air carriers so that unfair, market-distorting government subsidies would be more visible, and each agreement also included concessions from the sheikdoms about a related irritant: the proliferation of third-country stopover destinations on otherwise direct Gulf-carrier routes to and from the United States.

These accords are too new for any confident prediction to be made about how effective they will ultimately be in restoring open and fair competition to international commercial

aviation. The United States—and its allies in Europe and Asia, many of whose established airlines have also been hurt by subsidized SOE competition from the Persian Gulf—should remain highly vigilant until relevant data can be collected and analyzed. Qatar Airlines recently purchased the small Italian carrier Meridiana, restocked its aging fleet, rebranded the company "Air Italy," and began opening new international routes with third-country stopovers—which suggests an intention to evade the spirit of the U.S.-Qatari agreement. In the future, if the results prove disappointing, expanded use of the WTO or other trade agreements may be worth considering as a further tool to help address the problem of SOEs in general, not just those affecting the airline industry. In the meantime, however, the U.S. and its allies should vigorously pursue the guarantees of financial transparency and fair and equal opportunity to compete accorded to their domestic air carriers by the open skies system—and give cautious but serious consideration to the pursuit of additional open skies agreements with China, which currently operates outside the system's framework of rules.

Background

Commercial aviation, especially in the international arena, has long been an outlier in a world increasingly characterized by open competition and lightly regulated markets. The early years of the airline industry were dominated by national champion carriers, frequently owned by national governments. The experience of the two 20th Century world wars resulted in tight control over the use of air space, and the need to plan for emergency mobilizations provided major national governments a strong incentive to keep air fleets—even those privately owned—in strictly domestic hands.

Broader competition emerged after World War Two, as widening prosperity and technological advances in the jet era led to greater demand and lower costs for air travel. In the 1970s and 1980s the United States, then by far the world's largest market for air travel, deregulated its airline industry. As the European Union grew and became more market oriented, and the former Soviet bloc disintegrated and abandoned fully centralized command economies, new privately-owned airlines emerged to challenge the old system of national champion carriers and meet increasing demand.

Yet as the world's largest economies integrated and developed an elaborate system of open trade under the umbrella of what became the World Trade Organization (WTO), major elements of the older model for commercial aviation persisted. This was due in part to issues of air-space sovereignty and a continuing felt need to preserve national fleets. Commercial aviation, like most service industries, has never been included in the WTO system of disciplines for cross-border trade, and most countries still require majority domestic ownership of commercial passenger service providers.[1] As a result, the

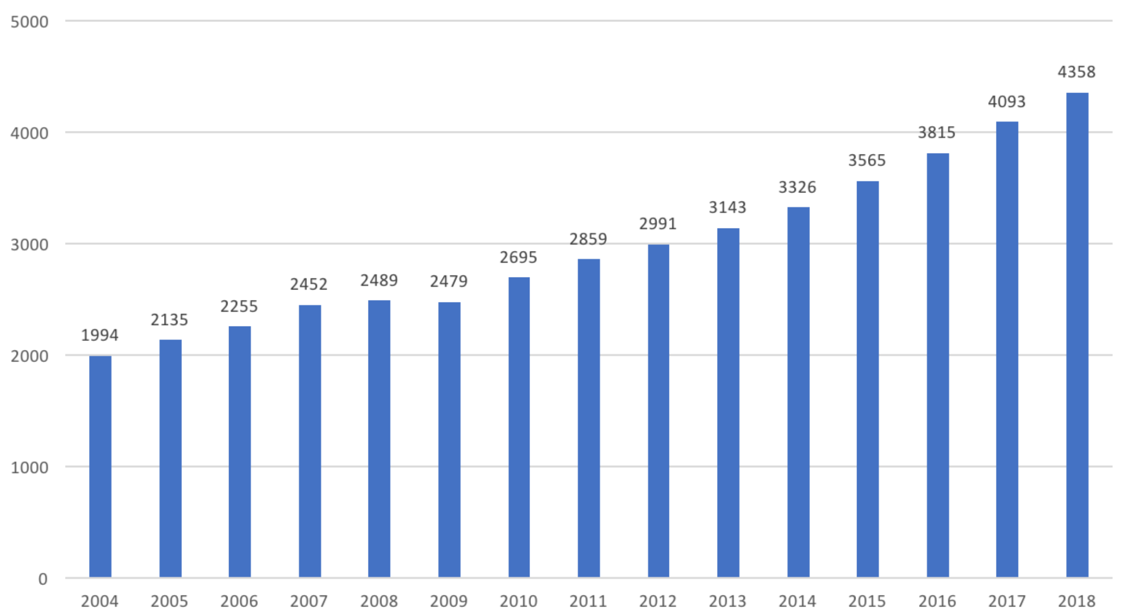
[1] Certain service-sector industries—like finance—have indeed been covered by important recent regional accords like the Transpacific Partnership (TPP). TPP also included specific disciplines for express air delivery services but continued to exclude coverage of commercial passenger aviation altogether. See Chapter 10 of the TPP text at https://ustr.gov/sites/default/files/TPP-Final-Text-Cross-Border-Trade-in-Services.pdf

international air market is now a mixed one, with many state-owned enterprises (SOEs) competing against mixed public-private and fully private entities.[2]

Figure 1 provides data on the huge increase in passenger traffic in recent decades. Traffic has grown by well over 200 percent since 2004.

FIGURE 1

Number of commercial airline passengers in millions



Source: https://www.statista.com/statistics/564717/airline-industry-passenger-traffic-globally/

To accommodate and facilitate the growing industry and the enormous increase in both international passenger and cargo traffic, especially after deregulation began in the 1970s, a complex series of bilateral and sometimes regional "Open Skies" agreements began to proliferate. With origins dating back to the Chicago Convention of 1944, the same year that the Bretton Woods agreement created the foundations for the post-war liberal trading system, these Open Skies texts were (and remain) agreed upon sets of rules by which mutually beneficial rights for establishing air services between signatories can be secured.[3] They also allow for flexibility in setting schedules, rates, and capacity (passenger and cargo alike), and for non-discriminatory treatment of carriers from each side.

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[2] About one-half of the countries with which the United States has Open Skies agreements have publicly-owned air carriers. See the full transcript of a May 2018 Hudson Institute conference on problems with Open Skies agreements at https://www.hudson.org/research/14362-full-transcript-are-gulf-state-airlines-taking-unfair-advantage-of-open-skies-agreements

[3] See Congressional Research Service, "International Air-Service Controversies: Frequently Asked Questions," Washington, May 4, 2015, at https://search.yahoo.com/search?p=international+air-service+cpmtrpversoes%3A+frequently+asked+questions&fr=yset_widemail_chr_win&type=default.
For more historical perspective, especially for the purposes of this paper on Middle Eastern carriers, see Mark Gerchick, "The Rise of the Aerostate: US Carriers Scrabble as Persian Gulf Rivals Emerge," *Washington Post,* April 30, 2016.

Importantly they require that: "Each Party shall allow a fair and equal opportunity for the designated airlines to compete" on generally accepted commercial grounds where regulation and access to support services are concerned.

The United States has Open Skies agreements with more than 120 partners, negotiated by the Departments of Transportation and State. They are executive agreements not subject to approval by Congress, which otherwise has constitutional authority over international trade. They provide legal certainty for the terms of commerce, including for air cargo services, while avoiding tedious negotiations over each and every change in route structures or numbers of landing slots for each airport pair served. Such agreements are of enormous benefit to both the airlines and their passengers. Brookings Institution economists Clifford Winston and Jia Yan estimate passenger benefits alone of $4 billion per year from Open Skies agreements.[4]

Distortions in Commercial Aviation Markets and Impacts on U.S. Carriers

In recent decades the biggest threat to the generally open, market-oriented international air services markets has come from the new and dynamic Middle Eastern airlines: Emirates Airline, Etihad Airways, and Qatar Airways (the "Middle East 3" or "ME3"). Founded in 1985, Emirates is the world's largest airline *by capacity*, although by no means the largest in terms of *revenue*. Etihad built its passenger traffic to 14 million per year by 2014, growing by 24 percent in 2014 alone.[5] Each ME3 carrier is building enormous new fleets of the most modern, largely widebody aircraft for competitive use in their central hubs on the Persian Gulf. These hubs are within eight hours flying time from 80 percent of the world's population. By 2017 Emirates and Etihad had 228 Boeing aircraft in their fleets and orders for another 300 on the books.[6] Emirates also has 101 Airbus A380 planes, which carry up to 500 passengers, in their fleet and another 77 on order.[7] Etihad has 66 Airbus airliners in their fleet and another 62 or order.[8] The government of Dubai—at a cost of approximately $32 billion—is building out what it claims will be the world's largest passenger airport to handle more than 200 million passengers per year and service 100 Airbus A380s simultaneously.[9] These investments are designed to continue building traffic from large and lucrative markets like the United States, Europe, and Asia. In 2006 Emirates flew to only one U.S. hub but had expanded that number to 13 by 2016.

The growth of the ME3 and the airports and other infrastructure that support them, according to forensic accounting work prepared for the Partnership for Open and Fair

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[4] See Clifford Winston and Jia Yan, "Open Skies: Estimating Travelers' Benefits from Free Trade in Airline Services," *American Economic Journal: Economic Policy 2015,* 7(2), pp. 370-414. http://dx.doi.org/10.1257/pol.20130071

[5] "International Air Services Controversies," p. 3. See also International Air Transport Association, *World Air Transport Statistics* (WATS), 59th Edition.

[6] See Ambassador Yousef Al Otaiba, "Open Skies is a Win-Win Deal for the UAE and the US," Pak Republican Council, 2017. https://pakrepublican.wordpress.com/2017/11/02/open-skies-is-a-win-win-deal-for-the-uae-and-the-u-s-op-ed-by-ambassador-yousef-al-otaiba/

[7] See https://www.emirates.com/media-centre/emirates-orders-36-a380s-worth-us-16-billion#

[8] See https://www.etihad.com/en/about-us/corporate-profile/our-fleet/

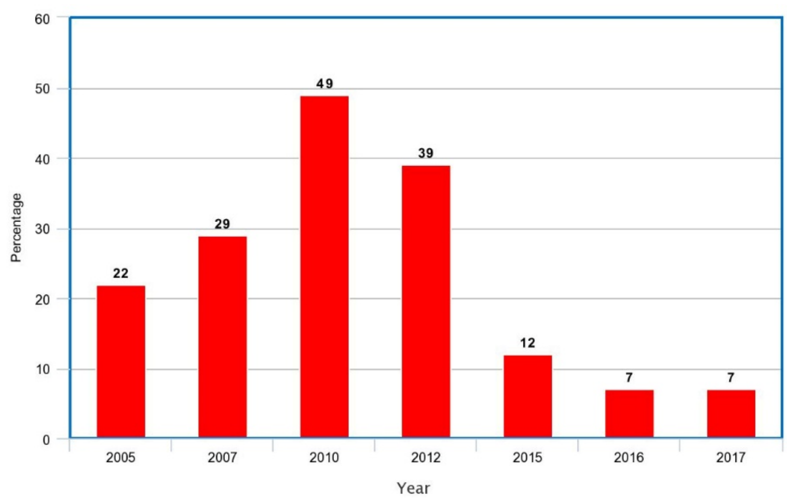
[9] International Air Services Controversies, p. 3.

Skies (the "Partnership," whose members are United, Delta and American Airlines as well as several pilot and flight attendant associations, and the airline division of the Teamsters), has been made possible in large part by substantial government subsidies from the oil kingdoms of Qatar and the UAE.[10] Total cash or in-kind subsidies of around $48 billion through 2015—along with about $4 billion in indirect benefits like below-market-rate jet fuel—have allowed the ME3 to achieve a ten-fold increase in daily passenger seats since 2001. In the U.S.-Dubai market, ME3 passenger seats on a daily basis increased by 435 percent since 2008, but total bookings remained basically flat. The result was a loss of market share for the three largest U.S. carriers, United, American, and Delta. As we will see in the next section, European carriers were even harder hit by the new competition. It is worth noting too that the ME3 do not pay income taxes, which in a market-oriented world is another form of subsidy.[11] In the United States, airline firms pay both income taxes and a substantial share of the cost of any expanded or modernized public infrastructure.

United, American, Delta, and their European counterparts (the continent's "big three" carriers Lufthansa, AirFrance/KLM, and British Airways parent IAG) remain the world's largest airlines *by revenue* and continue to operate the world's largest fleets by number of aircraft. The two major U.S. express air cargo firms, UPS and FedEx, rank in the top three in the world while Emirates has grown into the number two slot.[12]

Table 1 illustrates the loss of passenger market share by U.S. carriers for traffic between the United States and Middle East from 2005 to 2017. The bump in share observed for 2010-12 is likely due to recovery from an overall slowdown in international passenger demand during and after the great recession.

Table 1: US Share of Passenger Market, US-Mideastern Region



Source: U.S. Department of Transportation, *U.S. International Air Passenger and Freight Statistics* reports, December 2007, December 2012, and December 2017.

[10] See "Restoring Open Skies: The Need to Address Subsidized Competition from State-Owned Airlines in Qatar and the UAE," 2015. www.openandfairskies.com/subsidies.
[11] Gerchick, "Rise of the Aerostate,"
[12] See WATS, supra note 5.

The United States also lost overall international market share in passenger traffic during the same period. U.S. carriers sold 54 percent of all international seats to and from the United States in 2007, and 58 percent in the post-recession year 2012, but only 48 percent in 2017.[13] As we shall see in the next section, competition from SOEs in China and other nations also contributed to loss of market share by U.S. carriers.

Additionally, ME3 airlines contributed to lost business for U.S. carriers in the growing U.S.-India market, according to data compiled by the Partnership. Gulf airlines have exploited government subsidized service—and government-funded upgrades to their already geographically convenient hubs—to grow their market share for U.S.-India passenger travel from 8 percent in 2008 to 46 percent in 2016. U.S. carriers simultaneously lost around one-third of their passengers between the United States and India.[14]

The situation is arguably even worse for the European airline industry. The ME3 have substantially expanded flights and capacity to Europe and Asia over the last two decades. Moreover, they have started to capture traffic between Europe and the United States to Asia by offering connections to each destination through European hubs like Heathrow and Malpensa (Milan) airports. In 1998 the European big three ranked first, second, and third in terms of passenger seats available between the Europe/Middle East zone and Asia. But by 2016 Emirates alone offered more seats than the big three combined, and Qatar and Etihad ranked second and third. Between 2008 and 2016 the big three lost one-third of their market share between Europe and Asia, while the ME3 more than doubled its share. In 2016 the ME3 captured 29 percent of this market compared to 25 percent for the big three.[15] Figure 2 shows the growth in bookings between Europe and Asia from 2008 to 2018. The big three lost 8.5 percent in bookings during this period while the ME3 grew by more than 200 percent.

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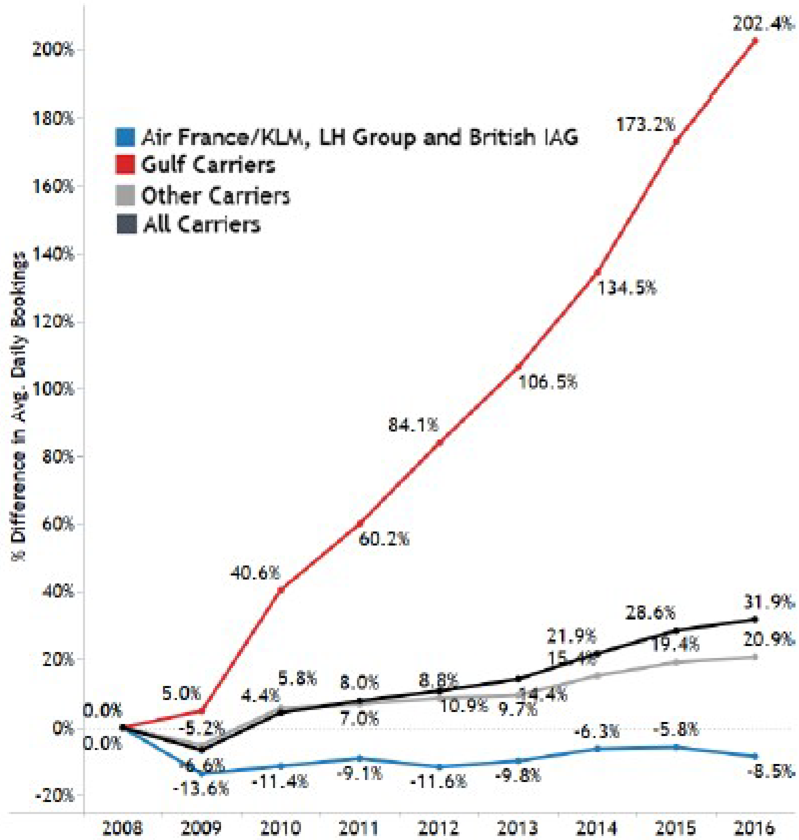
[13] See U. S. Department of Transportation, "US International Passenger and Freight Statistics Report," 2005-2017. https://www.transportation.gov/policy/aviation-policy/us-international-air-passenger-and-freight-statistics-report

[14] Partnership for Open and Fair Skies, "Presentation," www.openandfairskies.com/subsidies

[15] See Partnership for Open and Fair Skies, "Restoring Open Skies: Addressing Subsidized Competition from State-Owned Airlines in Qatar and the UAE," (Washington, 2018). Europe is defined as the 28 members of the European Union plus Switzerland, Norway and Iceland.

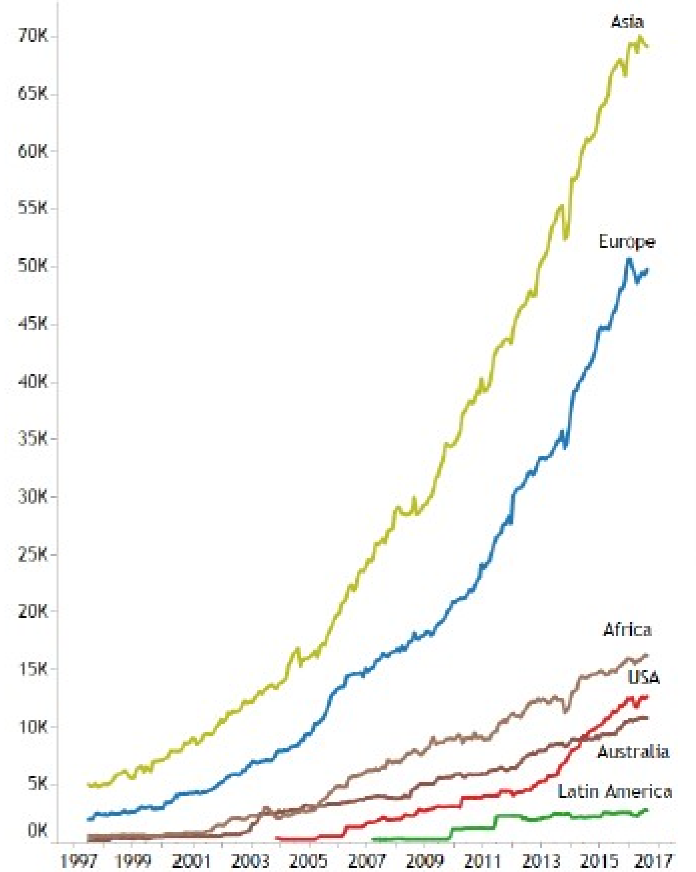
Figure 2: Growth in Bookings Between Europe and Asia Relative to 2008



Source: Partnership for Open and Fair Skies; Marketing Information Data Tapes (MIDT). Europe defined as the 28 members of the European Union plus Switzerland, Norway, and Iceland.

European carriers have been affected more than those in the United States by competition from the Middle East. Other established carriers, like Quantas, have also seen a drastic drop in their business as the ME3 expands to Asia. Figure 3 shows the rapid expansion in capacity by the Gulf airlines over the last two decades relative to competitors from major regions around the world. (In the following section of this paper we will see that the ME3 is now more aggressively targeting the United States.)

Figure 3: Expansion of Capacity by the ME3, 1997-2017 (Average Daily Seats by Gulf Carriers from Region)



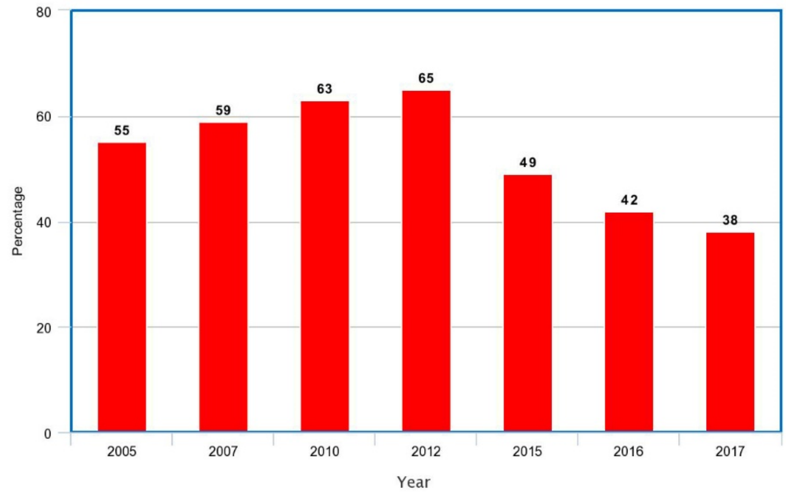
Sources: Partnership for Open and Fair Skies; OAG and Emirates website.
Europe defined as in Figure 2.

Gulf State-owned carriers are not the only SOEs leveraging heavy (and so far largely undisclosed) government subsidies to rapidly expand their share of the global passenger aviation market, of course. China's airlines have built dramatic new capacity to meet the local and international travel needs of its growing economy and middle class. Measured by number of passengers flown (using 2016 data), China Southern and China Eastern airlines now rank sixth and seventh in the world and measured by total miles flown both are among the world's top ten. China Southern and a third Chinese SOE, Air China, also now rank about the world's top ten carriers by passenger-distance measures, indicating their entry into especially valuable long-haul international markets.[16] China is very likely

[16] See WATS, supra note 5.

to become the world's largest air transport market in the near future.[17] And U.S. carriers have already begun to lose market share on China-U.S. routes. They now account for just 38 percent of passenger traffic on these routes, as Table 2 illustrates.

Table 2: US Airlines Market Share in US-China Routes, 2005-17



Source: U.S. Department of Transportation, *U.S. International Air Passenger and Freight Statistics* reports, December 2007, December 2012, and December 2017.

China's three largest airlines have grown their passenger numbers by 70 percent since 2010. They increased the capacity of their flights between the United States and China to 61 percent of total two-way capacity in the same time frame. Chinese airlines are even starting to take business from the ME3. "It is natural to expect China's carriers to eclipse those from the Gulf," says Will Horton of CAPA, an industry consultancy.[18] There is evidence of two types of subsidy helping propel this rapid growth. Tight capacity limits on many intra-China routes drive up prices and profits. And direct subsidies from local Chinese government agencies to build service to and from foreign destinations—and second-tier domestic cities like Chengdu, Xian, or Harbin—are common. One study has calculated that direct subsidies account for half the profits earned by China's four mainland-based international carriers.[19]

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[17] See Jon Ostrower, "China to Overtake the US as World's Largest Air Travel Market," *CNN Money,* October 27, 2017.
https://money.cnn.com/2017/10/27/news/china-biggest-air-travel-market-iata-forecast/index.html
[18] *Economist,* "Chinese Carriers are the new Disrupters in Air Travel," April 5, 2018.
https://www.economist.com/business/2018/04/05/chinese-carriers-are-the-new-disrupters-in-air-travel
[19] Bloomberg News, "China's Airlines Fly the World Riding on $1.3 Billion Subsidies," December 21, 2017.
https://www.bloomberg.com/news/articles/2017-12-21/china-s-airlines-fly-the-world-riding-on-1-3-billion-subsidies

As noted at the outset, the United States does not have a full Open Skies agreement with China and is embroiled in a series of increasingly consequential, broader trade disputes with the Middle Kingdom. This makes any potential agreement to liberalize air travel highly unlikely in the near-term future.[20]

Responses to Subsidized Competition by State-Owned Enterprises: Two Steps Forward and One Step Back

The United States has taken the lead in challenging subsidized competition from the ME3, utilizing the Open Skies agreements with Qatar and the United Arab Emirates. Article 11 of the U.S.-UAE text states clearly that "Each Party shall allow a fair and equal opportunity for the designated airlines of both Parties to compete."[21] A white paper commissioned by the Partnership for Open and Fair Skies substantiates claims of massive government subsidies to the ME3 carriers over the last two decades, cumulatively totaling more than $50 billion.[22] The acquisition of the world's largest fleets of new, long-distance, widebody aircraft and the construction of massive new airports (Qatar's Hamad airport is five times the size of Chicago's O'Hare) are among the results of direct and indirect subsidies. In a highly competitive global marketplace, with a business model characterized by very thin, single-digit profit margins, government support of such scale bends the balance heavily in favor of the ME3. Both the top three U.S. carriers and their labor unions support the charge of unfair competition.[23]

The Trump administration took up the case for challenging the ME3 in a September 14, 2017 interagency meeting led by the White House and the Departments of State and Transportation.[24] A decision was taken to use Article 15 of the Open Skies agreements to "take action to address the unfair behavior of the Gulf carriers" and to "seek disciplines on subsidies, transparency, and state-owned enterprises." The Administration also sought to secure specific commitments from the UAE and Qatar to freeze the opening of new services involving passengers picked up in third countries on flights between the U.S. and the Gulf states. (These are known as "5th freedom" rights in the Open Skies system.)

Subsequent negotiations with the two Gulf states resulted in 2018 agreements touted by the U.S. side as major steps forward on the problem of subsidies. The Qatar agreement was announced on January 30 at the U.S. State Department, with Defense Secretary Jim Mattis present, presumably to underscore the ongoing interest of defense planners in the importance of maintaining a vibrant and substantial commercial airline fleet for any

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[20] Some disagree with this assessment. See Centre for Aviation, "US-China Open Skies: A Window in 2019—Alignment of Airline Partnerships & Airport Infrastructure," April 29, 2017. https://centreforaviation.com/analysis/reports/us-china-open-skies-window-in-2019-with-alignment-of-airline-partnerships--airport-infrastructure-340603
[21] See "International Air Service Controversies," p. 4.
[22] Partnership for Open and Fair Skies, "White Paper," Jan. 28, 2015. www.openandfairskies.com/subsidies.
[23] Not all U.S. airlines support this position. See U.S. Airlines for Open Skies, www.openskiescoalition.com.
[24] See National Economic Council, "Summary of Conclusions for Small Group Meeting of Economic Deputies," September 14, 2017. The text is marked "sensitive but not classified."

future national defense or natural disaster contingencies.[25] Such high-level participation also signaled the Trump Administration's determination to ensure a fair playing field and preserve good paying jobs which are characteristic of the airline industry in the United States. Under the Qatar agreement, Qatar Airways promised to practice greater transparency in record keeping and reporting (in order to make any subsidies or favorable treatment more apparent) and to forego any new "5th freedom" passenger flights involving the United States. The two carriers covered by the UAE agreement pledged to "open up their accounting books by publishing annual statements 'consistent with international accounting standards.'" There was no formal agreement to freeze "5th freedom" routes with the UAE, but a side letter stating that the UAE carriers had "no current plans" to add more of these flights was also released, and U.S. carriers and the State Department understand this side letter as a binding commitment.[26]

The European Commission, spurred by its dominant members Germany and France, has also in recent years become concerned about "unfair" competition from Persian Gulf airlines.[27] Four other EU members supported a formal Commission initiative. The Partnership for Open and Fair Skies' "white paper" was cited in support of the EC decision to investigate competition from the ME3. A study of the allegations was ordered by the Commission but more than two years later that new report has not been completed. It is worth noting that the Europeans also cited potential unfair competition from Chinese, Turkish, and Brazilian state-owned airlines in mandating their review.

It is unclear whether the transparency components of the bilateral agreements negotiated by the United States, along with enhanced scrutiny from the EU, will produce significant reductions in subsidies from the Qatari and UAE governments to their national champion air carriers. It is simply too soon after these accords were finalized for new financial data to have been generated and scrutinized. There has been no apparent cancellation of orders for new wide-body aircraft or any slow-down in airport construction that might be attributable to withdrawal of some level of subsidy or indirect support.

Evidence has already emerged, however, to suggest that Qatar and its national champion carrier may be inclined to creatively evade aspects of their new bilateral commitments. In late 2017, Qatar took a 49 percent, controlling interest in the second-tier and failing Italian airline Meridiana. At the time of purchase the small regional carrier had shrunk to a fleet of just 11 aging aircraft. Qatar Airways' chief executive immediately announced that 20 new 737 MAX planes on order by his firm would supplement the Meridiana fleet. A strategy of growing the airline "to improve connectivity in Italy, other European destinations and to the United States would follow."[28] With Italy's national champion

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[25] See Kim Riley, "Open Skies Agreement with Qatar Foretells Strong US Enforcement to Protect Airline Industry," *Transportation Today News,* February 13, 2018.
[26] See Josh Lederman, "US, Emirates Strike Deal Resolving Airline Spat," *AP,* May 11, 2018. https://apnews.com/e1675afa09074bde9233f95954e44468
[27] See Ecaterina Casinge, "Committee to Review Competition from Gulf-based Airlines." https://www.euractiv.com/section/competition/news/commission-to-review-competition-from-gulf-based-airlines/, March 17, 2015. See also *Aviation Daily,* "EC Wins Four Open Skies Mandates," December 7, 2015.
[28] See Alexander Cornwell, "Qatar Airways Expands Airline Investments with Italy's Meridiana, *Reuters,* September 12, 2017. https://www.reuters.com/article/us-qatar-airways-italy-meridiana/qatar-airways-says-acquires-minority-stake-in-parent-of-italys-meridiana-idUSKCN1C32CC

Alitalia in bankruptcy, Qatar aims to build its stake in Meridiana, which it quickly rebranded as Air Italy, to become Italy's "real" national carrier. To expand internationally, as many as 30 Boeing 787 Dreamliners and/or Airbus A330 widebody aircraft are planned to be "transferred" to Air Italy's fleet from Qatar Airlines' existing order book.[29] The financial terms of this aircraft "transfer" are unclear, but no sale prices have been given. And these transactions come at a time when Qatar Airlines is already reporting large operational losses: $700 million in the 2016-17 fiscal year, and an expected "very large loss" in the current year.[30]

The CEO of Qatar Airways recently noted that if losses continue "we might have to approach our shareholders to inject equity into the company."[31] It is possible that the new transparency commitment in the 2018 U.S.-Qatar deal will prompt QA executives to detail whether the aircraft transfers are undertaken on anything resembling commercially routine terms and conditions, whether new subsidies will be granted to cover operational losses, and whether any real return is expected on the new capital injections that might be needed. The answers to these questions will have to wait until new financial statements are made available.

Air Italy is now offering regular service to Miami and New York from its new hub in Milan, and seasonal service from other Italian cities to the United States.[32] Direct flights to the two U.S. east coast hubs from Milan were inaugurated in June of 2018. Such service is certainly contrary to the spirit, if not the letter, of the January agreement on transparency and new "5th freedom" flight connections. In August 2018 Air Italy announced more frequent flights to Miami and new routes to Thailand and India from Milan, consistent with an overall strategy to win traffic from the United States to Asia and an expanding role in two-way U.S.-Italy traffic. "Qatar Airways group CEO Akbar Al Baker told ATW (an air transportation specialist website) that Air Italy should become successful 'in the next three years.' He added: 'We gave them 20 brand new 737 MAX and 30 787s initially. Then we can deploy bigger aircraft like 777s and A350s.'"[33] Such language does not suggest any backtracking from the carrier's traditional expansion plans. It is perhaps disingenuous to use what he calls "Italy's national carrier" to sustain this strategy, but as a purely political matter Qatar may be seeking to head off European action on subsidized service while finding a means to work around the January agreement. The U.S., ideally with support from the EU, should at a minimum enforce the transparency requirements of the January agreement to determine if the new Air Italy service is subsidized.

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[29] See Alexander Cornwell, "Qatar Airways Expects Meridiana to be Italy's 'real' National Carrier." *Reuters,* September 30, 2017. https://www.reuters.com/article/us-qatar-airways-meridiana/qatar-airways-expects-meridiana-to-be-italys-real-national-carrier-idUSKCN1C50NT

[30] See Victoria Bryan, "Qatar Airways to Report Very Large Loss for Current Fiscal Year: CEO." *Reuters,* March 7, 2018. See also, Victoria Bryan and Tim Helper, "Qatar Airways Could Face 2nd Straight Annual Loss Amid Gulf Crisis." *Reuters,* June 4, 2018. https://www.reuters.com/article/us-airlines-iata-qatar-airways/qatar-airways-could-face-second-year-of-losses-due-to-gulf-crisis-ceo-idUSKCN1J10D8

[31] Ibid.

[32] See Air Italy website: www.airitaly.com/en-us.

[33] See Kurt Hoffman, "Air Italy Increases Frequencies on Long-haul Routes," *ATW online,* August 8, 2018. www.atwonline.com/airports-routes/air-italy-increases -frequencies-long-haul-routes

Conclusions: More Work and Vigilance Needed by U.S. and Allies

There are some who question the value to consumers—or to the U.S. economy as a whole—of complaints about subsidization and unfair competition from state-owned airlines. Market purists argue that subsidized competition may be inefficient and ultimately self-defeating, but we should enjoy it while we can, since it tends to lower prices for airline customers and gives large traditional carriers additional incentives to improve service.[34] In this view of things, the ME3 are taking market share simply because they currently offer a superior product at a lower cost. It is only political miscalculations and internal disagreements among the Gulf states and their carriers, according to one proponent of these arguments, that has clouded the ME3's deserved success and prevented them from mounting a more effective, united response to their critics.[35] Moreover, some U.S. airlines—generally those with closer ties to the ME3 like Jet Blue and air cargo operators UPS and FedEx—are wary of pushing too hard on the subject of subsidies for fear that the clear and substantial broader gains derived from the Open Skies regime might thus be jeopardized. (Though these U.S. carriers, too, appear to be comfortable with the 2018 transparency agreements between the United States and the Gulf states.[36])

Nonetheless, it is hard to ignore the evidence for substantial government support and subsidies to the ME3 and the reality that market-oriented carriers in the United States, Europe, and elsewhere have lost market share at least partly as a result. The rise of China as an economic superpower in strategic competition with the West and its allies has also concentrated attention on the proliferation of subsidized SOEs, the commercial threat they pose to private firms, and the political threat Chinese economic ambitions pose to industrialized democracies in general.[37] This threat clearly extends to commercial aviation, as political influence is especially important in an industry with a history of "national champion" airlines and close coordination with national security interests. Not only the United States and Europe, but Australia, Japan, Hong Kong, Malaysia, and others are becoming ever more aware of the economic and political challenges posed by state-owned firms in China as well as the Gulf states.[38]

Given these concerns, encouraged by populist pushback against job losses and other economic disruptions attributed to globalization, American and allied political leaders are likely to intensify their efforts to combat the worst effects of subsidized foreign enterprises. In a 2018 conference at Hudson Institute on Open Skies, former Congressional Budget Office Director Douglas Holtz-Eakin responded to a question about a possible U.S.-China Open Skies with an analogy to the Cold War: "We knitted together

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[34] For example, see Ashley Nunes, "Government Airline Subsidies … So What?" *Forbes,* November 17, 2016. https://www.forbes.com/sites/realspin/2016/11/17/government-airline-subsidies-so-what/#58396e411f5f.

[35] See Adel Abdel Ghafar and Andrew Leber, "The Gulf's Airlines are Winning on Product but Losing at Politics." (Washington: Brookings Institution), *Markaz,* July 26, 2017.

[36] See U.S. Airlines for Open Skies website. www.openskiescoalition.com

[37] For example, see Thorsten Benner et. al, "Authoritarian Advance: Responding to China's Growing Political Influence in Europe," (Berlin, Merics and GPPI, 2018). http://www.gppi.net/publications/rising-powers/article/authoritarian-advance-responding-to-chinas-growing-political-influence-in-europe/?L=0%27..%27A%3D0&cHash=6fe0152c8a7683fd9de1a340240edc95

[38] "Chinese Carriers Are the New Disrupters in Air Travel," op. cit.

the Western Alliance against the threat of the Soviet Union, and we did it through trade and many other international agreements. We should do exactly the same thing with China."[39]

America's two 2018 agreements with the Gulf states are a start in addressing wider concerns about the challenge posed by SOEs to the Open Skies regime. But especially in view of the new and aggressive Qatari initiative with Air Italy, enforcing the letter of these agreements will require sustained, collective political vigilance by leaders of the world's major industrial economies. Given the broad impact of ME3 subsidies on Europe and other countries, it would be useful for the United States to work closely with its traditional allies on these issues. Constructive cooperation is already underway with respect to the newer threats from China. The United States, the EU, and Japan have an ongoing process to develop strategies to deal with Chinese violations of WTO rules on IPR, subsidies, and subsidized competition.[40]

Indeed, there is a growing perception that the market distortions and unfair competition resulting from subsidized SOEs might best be addressed in a broader, cross-industry context and with the kind of independent regulatory and dispute-resolution mechanisms employed by the WTO and various regional trade agreements. Multi-party trade pact rules do not generally cover service-sector industries like air transport, and efforts to extend such coverage to SOEs of any sort are fraught with controversy and likely to remain extremely difficult. The Trans-Pacific Partnership is a notable recent exception, however; driven in part by concern over Chinese SOEs, the TPP (to which the U.S. is not a signatory at this time) explicitly covers services, including air express services.[41] And if the specific threat to commercial aviation proves too difficult to solve through the Open Skies framework, recourse to the WTO and regional agreements may bear renewed and serious consideration. Nevertheless, for now, at least, the priority should remain firm and consistent enforcement of existing Open Skies agreements—and careful analysis of their ultimate effectiveness in counteracting the rise of subsidized competition from SOE air carriers.

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[39] See: Hudson Institute, "Full Transcript: Are Gulf States Taking Unfair Advantage of Open Skies Agreements," (Washington: Hudson Institute, May 20, 2018). https://www.hudson.org/research/14362-full-transcript-are-gulf-state-airlines-taking-unfair-advantage-of-open-skies-agreements

[40] See Voice of America, "US, EU, Japan Slam Market Distortion in Swipe at China," December 12, 2017. https://www.voanews.com/a/united-states-european-union-japan-slam-market-distortion-swipe-china/4161563.html

[41] See Minwoo Koo, "Regulating the Visible Hands: Development of Rules on State-owned Enterprises in Trade Agreements," *Harvard International Law Journal,* Vol. 58, #1 (Winter, 2017), pp. 225-272.